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Contemporary Tastes; How South Carolina's Regulation of the Craft Beer Industry Could Better Reflect Modern Societal Attitudes and Current Industry Needs

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CONTEMPORARY TASTES: HOW SOUTH CAROLINA'S REGULATION OF THE CRAFT BEER INDUSTRY COULD BETTER REFLECT MODERN SOCIETAL ATTITUDES AND CURRENT INDUSTRY NEEDS

I. INTRODUCTION

The consumer demand for beer produced by small, independent breweries has proven to be more than a fleeting trend. The consumer market for craft beer in South Carolina, and indeed all over the country, continues to grow and chip away at the market dominance of domestic (but non-craft) beer.[1] While in many ways a late arrival to the recent explosion in the industry, South Carolina is now home to seventy-seven breweries and nineteen brewpubs,[2] which together boasted an estimated $650 million

1. *See 2016 Brewery Statistics Now Available*, BREWERS ASS'N, https://www.brewersassociation.org/news/2016-brewery-statistics-now-available/ (last visited Mar. 26, 2018). Craft beer represented 12.3% of the market share of all beer purchased in the United States in 2016 and only 5.7% of the market five years earlier. *See 2015 Beer Data Infograph*, BREWERS ASS'N, https://www.brewersassociation.org/press-releases/2015-craft-beer-data-infographic/ (last visited Mar. 26, 2018).

2. *See Brewery Directory*, BREWERS ASS'N, https://www.brewersassociation.org/directories/breweries/ (last visited Mar. 26, 2018).

economic impact on the state last year.[3] In response to consumer trends, South Carolina lawmakers have taken steps to ease the regulatory burdens on the craft beer industry, recently passing laws that allow producers of beer to sell on-site food,[4] to sell beer directly to consumers,[5] to apply for liquor licenses under certain parameters,[6] and to make donations to nonprofit organizations that have special event permits.[7] Despite these recent changes, many of the laws and regulations that govern the craft beer industry in South Carolina remain entrenched in the past, surviving as relics of the prohibition era.[8] While some near century-old alcohol laws serve vital purposes for small, independent businesses in the modern craft beer industry—albeit likely not the purposes their original proponents imagined—a handful of laws persist in the South Carolina Code and in the daily lives of people in the craft beer industry, despite serving purposes that no longer reflect societal sentiments or address industry needs.

One preliminary issue that merits addressing is the definition of the designation "craft brewery." While this is an ongoing, interesting, and often highly-contentious debate, it remains outside the scope of this Note. For the purposes of this Note, I have adopted the Brewers Association's definition of a craft brewer: for a brewery to be categorized as a craft producer, it must be small,[9] independent,[10] and traditional.[11]

This Note will focus on the laws and regulations, both within and outside the three-tier system framework, that have a negative effect on craft brewers in the state and stand as hindrances to an industry that has exploded in South Carolina despite them. Additionally, this Note will compare the

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3. *See South Carolina Craft Beer Sales Statistics, 2016*, BREWERS ASS'N, https://www.brewersassociation.org/statistics/by-state/?state=SC (last visited Mar. 26, 2018) [hereinafter *S.C. 2016 Statistics*].

4. *See* S.C. CODE ANN. § 61-4-1515(B)(1) (Supp. 2014).

5. *See id.* § 61-4-1515(A).

6. *See id.* § 61-4-1515(B)(2).

7. *See* S.C. CODE ANN. § 61-2-185 (Supp. 2017).

8. For a historical discussion approaching the topic nationally, see generally GLEN WHITMAN, STRANGE BREW: ALCOHOL AND GOVERNMENT MONOPOLY (2003). For a South Carolina-specific discussion on the antiquated nature of alcohol regulation, see JOHN D. GEATHERS & JUSTIN R. WERNER, THE REGULATION OF ALCOHOLIC BEVERAGES IN SOUTH CAROLINA (2007) [hereinafter THE GEATHERS' TREATISE].

9. *See Craft Brewer Defined*, BREWERS ASS'N, https://www.brewersassociation.org/statistics/craft-brewer-defined/ (last visited Mar. 26, 2018) ("Annual production of 6 million barrels of beer or less (approximately 3 percent of U.S. annual sales).").

10. *See id.* ("Less than 25 percent of the craft brewery is owned or controlled (or equivalent economic interest) by an alcohol industry member that is not itself a craft brewer.").

11. *See id.* ("A brewer that has a majority of its total beverage alcohol volume in beers whose flavor derives from traditional or innovative brewing ingredients and their fermentation.").

laws and regulations affecting craft beer in South Carolina with those of similarly situated states, namely North Carolina and Georgia. Our federalist-minded founders envisioned individual states as breeding grounds for progressive experimentation that would serve to inspire and propel forward other states, in turn bettering the collective nation.[12] To that optimistic end, this Note will analyze the ways in which North Carolina and Georgia, states that are geographically similar to South Carolina and had nearly identical laws regulating beer before the arrival of "the craft beer revolution," have met the relatively recent explosion of the industry. Since each state met the change in market demand on a nearly equal legal footing, subsequent changes to each state's regulation scheme provide useful comparisons for their respective effects on the industry. Further, this Note will expound upon a few other state policies around the nation, unique in their progressive approaches to fostering success in the craft beer industry.

To promote further growth in the burgeoning craft beer industry and to ensure a legal environment in which brewers can successfully pursue their craft, South Carolina should ensure that current laws: (1) properly reflect current societal goals with respect to modern attitudes on beer; and (2) properly address the current needs of those in the industry. Specifically, South Carolina should revise its laws to provide exceptions to the traditional regulatory framework for small-scale producers, while continuing to encourage fair market practices by limiting the influence and integration ability of large-scale producers. To this end, South Carolina's changes to its three-tiered framework should reflect the one initial purpose of the system that remains applicable to modern society: promoting the independence of a distribution tier that precludes the market domination of large-scale producers, thereby ensuring fair competition among brewers in the marketplace, both large and small. Additionally, South Carolina can capitalize on the still-growing demand for craft beer, bringing money into the state while being mindful of the small craft brewery business, by providing meaningful tax credits to small-batch breweries, offering grants that reward breweries for worthy efforts to promote tourism, and restructuring antiquated laws that govern franchise agreements. State lawmakers should look to how similarly situated states have reacted to the market demand for craft beer, emulating practices of those that have embraced change and noting the cautionary example of those states that remain entrenched in the past.

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12. *See, e.g.*, New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (commenting that a "happy incident" of federalism allows states to serve as "laboratories" for "social and economic experiments").

II. THE REGULATION OF BEER IN SOUTH CAROLINA

While new consumer tastes for more flavorful and interesting beer have propelled the recent growth of the craft industry, America's affinity for beer is long-standing and well-documented.[13] Cultural perceptions of beer, however, have varied drastically.[14] At the height of the temperance movement, in early twentieth-century America, prohibitionists associated beer with the moral pitfalls of the saloon, which connoted chronic intemperance, sexual amorality, and poor character.[15] Given the current cultural climate and near-sanctification of beer as America's national beverage, it's hard to believe that states ratified the Eighteenth Amendment, which made illegal any sale of alcohol across the nation, less than a century ago.[16] While American sentiments disfavoring alcohol remained intact, the nation soon realized that the prohibition experiment, while a noble one, was failing.[17] The legal framework that regulates the modern beer industry is a direct result of the failure of the prohibition experiment, which occurred among a societal climate that still associated alcohol with the evils of intemperance.[18] A nationwide ban on alcohol no longer a viable option, state lawmakers implemented policies under the very same spirit that had helped ratify the Eighteenth Amendment.

A. The Three-Tier System

The repeal of the Eighteenth Amendment, by way of the Twenty-First Amendment, placed alcohol regulation once again under the purview of the

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13. For a discussion of beer's origins in the United States, see GREGG SMITH, BEER IN AMERICA: THE EARLY YEARS—1587–1840: BEER'S ROLE IN THE SETTLING OF AMERICA AND THE BIRTH OF A NATION (1996). For a discussion on the solidification of beer as an American beverage, see also Lisa Jacobson, *Beer Goes to War: The Politics of Beer Promotion and Production in the Second World War*, 12 FOOD, CULTURE & SOC'Y 275, 275–312 (2009).

14. For a discussion on the competing interests and ideologies surrounding the prohibition experiment, see generally DANIEL OKRENT, LAST CALL: THE RISE AND FALL OF PROHIBITION (2011).

15. *See* RAYMOND B. FOSDICK & ALBERT L. SCOTT, TOWARD LIQUOR CONTROL 10 (Ctr. for Alcohol Pol'y 2011) (1933) ("The saloon, as it existed in pre-prohibition days, was a menace to society and must never be allowed to return.").

16. *See* U.S. CONST. amend. XVIII, § 1 ("After one year from the ratification of this article the manufacture, sale, or transportation of intoxicating liquors within, the importation thereof into, or the exportation thereof from the United States and all territory subject to the jurisdiction thereof for beverage purposes is hereby prohibited."), *repealed by* U.S. CONST. amend. XXI.

17. John D. Rockefeller, Jr., *Foreword* to FOSDICK & SCOTT, *supra* note 15, at xiii.

18. *See* Jim Petro et al., *Introduction* to FOSDICK & SCOTT, *supra* note 15, at vi.

states.[19] John D. Rockefeller, Jr., among the nation's most influential proponents of alcohol abstinence, funded a study in an attempt to solve the nation's intemperance problem, the result of which has "done more to shape modern American alcohol policy than any other book except the Bible."[20] In *Toward Liquor Control*, the aforementioned result of Rockefeller's study, lawyer Raymond B. Fosdick and engineer Albert L. Scott advocated for extensive state regulation of alcohol with the stated goals of (1) curbing the amoral effects of alcohol; and (2) eliminating the restraints on the free market caused by the undue influence of large-scale producers over small-scale retailers as well as the industry's affiliation with crime networks.[21] The solution was the aptly-named "three-tier system."[22] While the system has evolved significantly, developing a seemingly myriad array of complexities since its conception, its central tenet remains simple. At its core, the system mandates that each stage of the supply chain remain separate and independent, thus creating three distinct tiers: the production tier, the distribution tier, and the retail tier.[23] In addition to prohibiting the concentration of power and influence among large-scale producers, the three-tier system also promised the effect of promoting temperance, thereby quelling the amoral societal effects of overconsumption.[24] Courts have often noted the prevailing influence of temperance as a motivation when analyzing the three-tier system.[25]

"Tied houses" were one such post-prohibition concern that exemplified all the amoral associations alcohol held among the public and motivated advocates of the three-tier system.[26] A tied house referred to a retailer

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19. *See* U.S. CONST. amend. XXI, § 2 ("The transportation or importation into any state, territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.").

20. Jim Petro et al., *supra* note 18, at vii.

21. *See* FOSDICK & SCOTT, *supra* note 15, at 9–11 (establishing the goals of state regulation, including eliminating the illegal activities that dominated the prohibition-era black market for alcohol, ensuring the non-return of the pre-prohibition saloon, and limiting the influence of large liquor producers).

22. *See id.* at 27–31 (detailing the "methods of license" states should enact).

23. *See* Marc Sorini, *Understanding the Three-Tier System: Its Impacts on U.S. Craft Beer and You*, CRAFT BEER (Mar. 6, 2017), https://www.craftbeer.com/craft-beer-muses/three-tier-system-impacts-craft-beer (providing a brief history of the three-tier system and general overview of its operation).

24. *See id.*

25. *See, e.g.*, North Dakota v. United States, 495 U.S. 423, 439 (1990); Arnold's Wines, Inc. v. Boyle, 571 F.3d 185, 188 (2d Cir. 2009).

26. *See* FOSDICK & SCOTT, *supra* note 15, at 29 ("'Tied houses' should, therefore, be prohibited, and every opportunity for evasion of this system should, if possible, be foreseen and blocked.").

(usually a saloon) that was owned, at least in part, by a producer who was usually affiliated with organized crime.[27] As a result, the retailer sold only the producer's product and free competition was stifled.[28] Tied houses represented one of the many amoral effects of alcohol that new state regulation would be structured to prevent. Those almost century-old motivations established the legal framework for the regulation of the production, distribution, and sale of alcohol that remains in place today.

Much academic discussion has centered on the three-tier system, which now exists in nearly every state and mandates the divorcement of production, distribution, and retail operations.[29] Nearly every law and regulation that governs the beer industry in South Carolina operates within the three-tiered framework[30]: the producers of the beer make up one tier; distributors (often called "wholesalers") make up the second tier; and retailers who sell beer to the consumer make up the third.[31] Generally, states enforce the system by requiring a business in the alcohol industry to obtain a license for its desired tier and prohibiting any business from having licenses across tiers. Thus, within the three-tier system, as a practical matter, alcohol is produced only by licensed producers, distributed only by licensed distributors, and then sold to consumers only by licensed retailers. Despite challenges to the three-tier system's validity under the Commerce Clause, the Supreme Court has found the regulatory framework to be "unquestionably legitimate."[32]

South Carolina enforces its three-tier system as most states do: laws requiring separate licenses for producers, distributors, and retailers.[33] South Carolina followed the majority of states, adopting Fosdick and Scott's plan for alcohol regulation shortly after the ratification of the Twenty-First

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27. *See id.*

28. *See* Lindsey A. Zahn, *Is There a Future for the Three-Tier Alcohol Beverage Distribution System?*, ON RESERVE (July 28, 2010), https://www.winelawonreserve.com/2010/07/28/is-there-a-future-for-the-three-tier-alcoholic-beverage-distribution-system/ (describing the chilling effect of the three-tier system on competition within the wine industry in particular).

29. *See* Sorini, *supra* note 23.

30. *But see infra* Section II.C (discussing the brewpub designation as existing outside the confines of the three-tier system).

31. *See* Sorini, *supra* note 23 (providing a general overview of the three-tier system's operation).

32. Granholm v. Heald, 544 U.S. 460, 489 (2005) (holding that New York and Michigan laws, which permitted in-state wineries to ship wine to consumers, but prohibited out-of-state wineries from doing the same, violated the Commerce Clause of the Constitution under the doctrine of the "dormant commerce clause").

33. S.C. CODE ANN. § 61-4-940 (2009).

Amendment.[34] As is the case in most states, the system in South Carolina provides the basis for state alcohol regulation; it affects, and is affected by, nearly any change in the law. By way of enforcement, laws mandate that any business in the industry apply to the South Carolina Department of Revenue (DOR) for a permit to enter a desired tier.[35] The DOR has, on many occasions, denied the applications of businesses that try to operate on multiple tiers.[36]

The most tangible and obvious effect of the divorcement of tiers in the craft beer industry is that breweries may not self-distribute. Rather, a producer is legally obligated to go through a distributor to get its product to market. That prevailing effect of the system, however, tends not to plague South Carolina brewers, who prefer to contract out distribution since self-distribution would likely not be economically feasible for small-scale brewers.[37] Edward Westbrook, co-founder of Westbrook Brewing Company, indicated that his disinterest in self-distribution reflects a common sentiment among all small brewers in South Carolina.[38] Aside from economic infeasibility, brewers have other reasons to favor independent distribution over self-distribution. The National Beer Wholesalers Association notes that the existence of an independent distribution tier results in economic efficiencies by way of fewer direct connections between the first and third tiers.[39] While the exact effects are disputed, independent distribution provides, at minimum, a wider market range of distribution for small breweries.[40] Westbrook Brewing, for example, remains a (relatively) small brewing operation but is nonetheless able to distribute beer to markets as

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34. *See History*, S.C. BEER WHOLESALERS ASS'N, https://www.scbwa.com/about-us (last visited Sept. 30, 2017); *see also* S.C. CODE ANN. § 61-4-940 (2009).

35. S.C. CODE ANN. § 61-4-310(A) (2009).

36. *See, e.g.*, *infra* Section II.C (discussing DOR's denial of a permit application by Hunter-Gatherer, LLC).

37. Interview with Edward Westbrook, Founder, Westbrook Brewery, in Mount Pleasant, S.C. (Nov. 2, 2017) [hereinafter Westbrook Interview] ("I think unless you're talking about one of the massive producers, craft brewers couldn't afford to self-distribute anyways. I also see where [self-distribution] could also be an attractive option for smaller, hyper local breweries.").

38. *Id.* ("Not only is self-distribution not a priority for us, it wouldn't be feasible. Small brewers recognize it wouldn't be feasible economically . . . .Wholesalers also provide a service that [small South Carolina brewers] couldn't focus properly on and couldn't do a good job at [compared to the job our distributors do].").

39. *See* WILLIAM LANTHAM & KENNETH LEWIS, NAT'L BEER WHOLESALERS ASS'N, AMERICA'S BEER DISTRIBUTORS: FUELING JOBS, GENERATING ECONOMIC GROWTH & DELIVERING VALUE TO LOCAL COMMUNITIES 8 (2013), http://nbwa.org/sites/default/files/NBWA-Economic-Report-2013.pdf [hereinafter NBWA ECONOMIC REPORT].

40. *See id.* at 12 ("Small brewers are able to reach wider markets through the access distributors provide so that consumers have more choice.").

distant as New York and California.[41] That wide distribution range would likely not be possible for small producers that attempted to self-distribute.

While some of the criticism directed towards the system is well-founded, the three-tiered framework in South Carolina very likely has a net positive effect on the craft beer industry. While large-scale production companies, like AB InBev,[42] dominate several aspects of the market, including advertising, sponsorship, and sales,[43] the three-tier system allows for an independent distribution tier to mitigate the influence that mega-producers could exercise over retailers. The second tier of the industry acts as a buffer between producer and retailer; without it, the process could be streamlined, and large-scale producers would be able to exert direct influence on retailers, who might receive benefits for exclusively supplying certain brands, for example. The Brewers Association, as well as local South Carolina brewers,[44] note the importance of the independent second tier:

> The [Brewers Association] supports the independence of wholesalers and believes independent wholesalers are wholesalers who are contractually and economically free to allocate their efforts among the brands they sell without the undue influence of their largest suppliers. Each brand gets the attention it deserves on its own merits in the marketplace.[45]

While some outdated aspects of the three-tier system place hindrances on the craft beer industry in South Carolina, its central tenet, the divorcement of producer and retailer by way of an independent second tier,

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41. Westbrook Interview, *supra* note 37.

42. After acquiring SAB Miller in 2015 for $106 billion, AB InBev's share of the global beer market jumped to an estimated twenty-eight percent. *See* Michael J. de la Merced, *Anheuser-Busch InBev Merger With SABMiller Wins U.S. Antitrust Approval*, N.Y. TIMES (July 20, 2016), https://www.nytimes.com/2016/07/21/business/dealbook/anheuser-busch-miller-merger-wins-us-antitrust-approval.html.

43. *See* AB INBEV, ANNUAL REPORT 2016, at 24 (2016), http://www.ab-inbev.com/content/dam/universaltemplate/ab-inbev/investors/reports-and-filings/annual-and-hy-reports/2017/03/AB%20InBev%20Annual%20Report%202016%20-%20Financial%20report.pdf (reporting over $7 billion on marketing expenses and over $45 billion in revenue for 2016).

44. Westbrook Interview, *supra* note 37 (discussing, at length, the vital role of an independent distribution tier in prohibiting market domination by mega-brewers: "[The distribution tier] insulates the smaller brewers and protects us from the big guys. An independent middle tier helps to keep the big guys in check—it protects everyone else in the retail and consumer tier from being dominated by the conglomerates").

45. *Government Affairs, BA Position Statements*, BREWERS ASS'N, https://www.brewersassociation.org/government-affairs/ba-position-statements/ (last visited Feb. 6, 2018).

remains the craft industry's strongest defense against an oligopoly in which three or four producers would stand to lay claim over the entire beer market.

As discussed *supra*, one of Fosdick and Scott's primary goals in establishing a system of post-prohibition alcohol regulation was to extinguish the prevailing influence of "tied houses" on the alcohol industry.[46] When the majority of states adopted Fosdick and Scott's three-tier system of alcohol regulation, most did so with an explicit tied-house statute, and South Carolina was no exception.[47] South Carolina's tied-house statute is characteristically succinct and explicit: "A person or an entity in the beer business on one tier, or a person acting directly or indirectly on his behalf, may not have ownership or financial interest in the beer business operation on another tier."[48] Despite the statute's seemingly iron-clad rigidity, business owners in South Carolina have found a way to simultaneously own production and retail operations, by way of the brewpub exception, discussed in depth *infra*.[49] However, the utilization of that exception for the purpose of circumventing the tied-house statute can have significant negative effects, also discussed *infra*.[50]

B. Franchise Laws

While not products of the prohibition-era temperance movement, beer franchise laws no longer reflect the attitudes and needs of the craft beer industry and remain a common source of complaints among brewers.[51] Operating within the three-tier system, franchise laws, enacted in the 1970s, govern contract agreements between those on the production tier and their distributors.[52] The laws strictly regulate all contracts between brewer and distributor and serve to heavily tip the bargaining power scale in favor of the

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46. *See* FOSDICK & SCOTT, *supra* note 15, at 29 ("'Tied houses' should, therefore, be prohibited, and every opportunity for evasion of this system should, if possible, be foreseen and blocked.").

47. *See* S.C. CODE ANN. § 61-4-940(D) (Supp. 2014).

48. *Id.*

49. *See* discussion *infra* Section II.C (discussing the brewpub designation as an exception to the three-tier system).

50. *See* discussion *infra* Section II.C (noting the difficult decisions brewpub owners face, in light of recent changes to the law and South Carolina's tied-house statute).

51. *See, e.g.*, Steve Hindy, *Free Craft Beer!*, N.Y. TIMES (Mar. 29, 2014), https://www.nytimes.com/2014/03/30/opinion/sunday/free-craft-beer.html?_r=1 (explaining brewers' common complaints in regards to state franchise laws).

52. *See* Marc E. Sorini, *Beer Franchise Law Summary*, COUNS. FOR THE BREWERS ASS'N (2014), https://s3-us-west-2.amazonaws.com/brewersassoc/wp-content/uploads/2017/04/Beer-Franchise-Law-Summary.pdf.

distributor.[53] Beer franchise laws continue to govern contracts between producer and distributor in some form or another in a majority of states.

South Carolina passed its own franchise laws in 1976,[54] at a time when industry dynamics provided some justification for the laws. Then, over 5,000 distributors in the United States competed for the business of only fifty breweries.[55] Large-scale breweries had a significant bargaining power advantage over considerably smaller distributors.[56] Imagine the common scenario in which a small distributor's entire business hinged on a single contract with a major brewer. If after the distributor had invested heavily in refrigerated trucks, warehouses, and a varied staff, the bottom-line-minded large-scale brewer cancelled the contract to pursue a more favorable agreement—the distributor was left out to dry. Thus, states passed franchise laws in an effort to place producers and distributors on an equal footing.[57] As is the case with most alcohol regulation, temperance was also a motivating factor.[58]

Today, industry numbers do not reflect the same need for a check on the bargaining power of small-scale producers: in 2014, fewer than 1,000 viable national distributors served more than 2,700 breweries.[59] While large-scale producers still have a bargaining advantage over small distributors for the reasons outlined above, the majority of producers are small and independent with no greater bargaining power than an independent distributor. While franchise laws provide a justified power check for contracts of unequal bargaining power, i.e., those between independent distributors and large-scale producers, the laws serve no material purpose in contracts between parties on an equal footing, i.e., distributors and small-scale producers. The mere plain language of South Carolina's franchise statute hints at the law's underlying bias against all producers: "It is unlawful for a producer . . . to coerce, attempt to coerce, or persuade [a distributor] to enter into an

53. *See id.*

54. *See* S.C. CODE ANN. § 61-4-1100 (2012) (previously codified as S.C. CODE ANN. § 61-9-1010 (1976)).

55. *See* Sorini, *supra* note 52 (detailing how most states have enacted at least a few laws that regulate brewer-wholesaler relations as opposed to before these laws, where the relations were governed exclusively by the terms of the parties' contract).

56. *See id.*

57. *See id.* ("Although it is not hard to detect a whiff of protectionism in these enactments, their stated purpose is to correct the perceived imbalance in bargaining power between brewers (who are presumed to be big and rich) and wholesalers (who are presumed to be small and local).").

58. *See id.* ("Temperance concerns are also cited.").

59. *See* Hindy, *supra* note 51.

agreement to take any action which would violate a provision of this article . . . ."[60]

While South Carolina craft brewers have acknowledged the benefits of recent changes to South Carolina's beer laws,[61] considerable concerns still exist over franchise laws. Franchise laws vary from state to state,[62] and South Carolina's are among the nation's most restrictive. In South Carolina, a contract between producer and distributor cannot be terminated by either side without giving the other sixty days' notice in writing.[63] Further, the written notice must include:

> (i) assurance that the agreement or contract, written or oral, franchise, or contractual franchise relationship is being terminated in good faith and for material violation of one or more provisions which are relevant to the effective operation of the agreement or contract, written or oral, franchise, or contractual franchise relationship, if any, and (ii) a list of the specific reasons for the termination or cancellation.[64]

In addition to the good faith and material violation requirements, the laws state that neither party can cancel the contract "without due regard to the equities of the [other party] or without just cause or provocation."[65] These laws govern producer-distributor agreements even when the contract is assigned to a different party.[66]

South Carolina's beer franchise laws have the strange effect of keeping a producer and distributor in contract, whether either wants to continue business with the other or not, and only allowing for the termination of a contractual relationship upon a good faith showing of a material violation of the agreement. The incentive structure favors a race-to-the-bottom relationship, in which neither party is motivated to act to the benefit of the other.[67] With these laws in place, distributors could fall short of providing services that are important to brewers, while not performing poorly enough to satisfy a court's definition of committing a material violation: failing to

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60. S.C. CODE ANN. § 61-4-1100(1)(a) (Supp. 2014).
61. *See infra* Section II.C.
62. *See, e.g.*, *infra* Section III.A (discussing the nuances between franchise laws in South Carolina, North Carolina, and Georgia).
63. *See* S.C. CODE ANN. § 61-4-1100(1)(b) (Supp. 2014).
64. *Id.*
65. *Id.*
66. S.C. CODE ANN. § 61-4-1115 (Supp. 2014).
67. *See* Hindy, *supra* note 51.

keep the beer cold at all times, for example.[68] More instinctively, these laws ignore the human element of conducting business: brewers and distributors who simply do not get along well with one another are stuck in a contractual relationship. Additionally, small brewers often find themselves with no recourse when stuck in a contract with a distributor, even if the distributor has committed material violations, because the small brewer does not have the money to sue.[69]

Edward Westbrook, while acknowledging his company's good fortune in having a great relationship with an effective distributor, noted that a bad relationship with a distributor could mean the death of a small brewery that lacks the means to cancel the franchise contract.[70] Larger breweries, like Brooklyn Brewery in New York and Dogfish Head in Delaware, for example, have expended as much as $300,000 in legal costs and fees to cancel contracts with distributors.[71] It stands to reason that smaller breweries could not endure a legal battle so costly. According to economist Jacob Burgdorf, franchise laws in the South Carolina beer industry have "encouraged opportunism by [distributors] and increased costs to brewers as these laws decreased craft brewery entry and production and increased prices."[72] Foundationally, the laws place a significant limitation on producers' and distributors' right to contract by (1) limiting a party's ability to terminate to situations in which the other party has committed material malfeasance; and (2) mandating an exclusive remedy that is costly and inefficient.[73]

Aside from mandating certain unwaivable contract terms, state franchise laws also typically include provisions which grant distributors the exclusive right to distribute a particular brand to a particular territory. These laws are referred to as mandated exclusive territory laws. Mandated exclusive territory laws place additional restraints on brewers' freedom of contract

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68. *See id.*

69. *See id.*

70. Westbrook Interview, *supra* note 37 ("Yeah, one contract with a distributor can sink a small brewery just starting out if things aren't working out . . . . Everyone [in the industry] knows about instances of a brewery being stuck in a contract with no [economically feasible] way out.").

71. *See* Hindy, *supra* note 51 (noting that Brooklyn Brewery, settling outside of court after a months-long legal battle, had expended $300,000 to cancel a distributor contract, from a dispute that arose when the distributor continued to supply out-of-date beers to retailers. New York's state franchise laws governed the means by which Brooklyn Brewery could cancel, despite the clear terms of the contract that stated the contract could be voided "with or without cause").

72. Jacob E. Burgdorf, Essays on Mandated Vertical Restraints 6 (May 2016) (unpublished Ph.D. dissertation, Clemson University).

73. *See* S.C. CODE ANN. § 61-4-1100 (Supp. 2014).

while also hindering market competition by ensuring that distributors will not compete within a given territory.[74] South Carolina's beer franchise laws, along with the franchise laws of thirty-seven other states, give distributors exclusive distribution rights to the producer's product in that territory.[75]

Steve Hindy, founder and president of Brooklyn Brewery in New York, noted the debilitating effect that mandated exclusive territory laws can have on independent breweries, particularly the smallest in the industry.[76] Because franchise laws make it difficult for a small brewer to get out of a contractual relationship, as discussed above, and because a single distributor has the exclusive right to sell that brewer's beer within a particular territory, Hindy argues that small producers have no control over how their product is sold.[77] Distributors can choose to market certain beers from particular brands, while others "sit in their warehouses."[78] Some small producers even refuse to enter certain markets because of the reputation of local distributors.[79] Once again, brewers are left with no recourse but to sue, an option too costly for many small producers. Mandated exclusive territories remain the most common area of criticism in the industry, with the majority of brewers supporting change.

Studies into the economic effects of mandated exclusive territories, however, have been largely mixed. While the voluntary use of exclusive territories has been shown to reduce competition[80] or prevent entry,[81] other studies have found that it aligned incentives between producer and distributor and prevented distributors from free-riding on the efforts of distributors in the same territory.[82] Analysis into the effects of mandated exclusive territories has proved even more challenging. Examined empirically, studies have found that mandated exclusive territories have the

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74. *See* Hindy, *supra* note 51.

75. *See id.*

76. *See id.*

77. *See id.* ("The contracts not only prevent other companies from distributing a company's beers, but also give the distributor virtual carte blanche to decide how the beer is sold and placed in stores and bars—in essence, the distributor owns the brand inside that state.").

78. *Id.*

79. *Id.*

80. *See generally* Patrick Rey & Joseph Stiglitz, *The Role of Exclusive Territories in Producers' Competition*, 26 RAND J. ECON. 431 (1995) (studying the effect of exclusive territories in producers' competition).

81. *See* John Asker & Heski Bar-Isaac, *Raising Retailers' Profits: On Vertical Practices and the Exclusion of Rivals*, 104 AM. ECON. REV. 672, 672–86 (2014).

82. *See generally* Benjamin Klein & Kevin M. Murphy, *Vertical Restraints as Contract Enforcement Mechanisms*, 31 J.L. & ECON. 265, 265–97 (1988) (examining the vertical restraints as contract enforcement mechanisms).

effect of increasing prices,[83] although other studies suggest that the increase in price is accompanied by an increase in quality.[84] With respect to craft breweries in South Carolina, Burgdorf found that the use of mandated exclusive territories has exclusively negative effects, decreasing the entry of breweries to the market and increasing prices.[85]

The Brewers Association advocates for an exception to state franchise laws, similar to that which exists in New York, based on a percentage of distributor business:

> [The Brewers Association] believes that small brewers and wholesalers should be free to establish enforceable contracts between the parties that both parties agree are fair and equitable. Franchise laws were enacted to protect wholesalers from the undue bargaining power of their largest suppliers. Applying those laws to the relationship between a small brewer and the wholesaler is unfair and against free market principles. Where franchise laws exist, the BA believes that any brewer contributing a small percentage of a wholesaler's volume should be exempted from those laws and free to establish a mutually beneficial contract with that wholesaler. Without the leverage inherent in being a large part of a wholesaler's business, a small brewer and wholesaler can negotiate a fair contract at arm's length.[86]

C. Recent Changes in Beer Regulation

After the implementation of South Carolina's franchise laws in 1976, regulation policy stagnated for nearly two decades. In 1996, as craft beer just began its climb in popularity in the southern United States, the South Carolina legislature passed the "brewpub law," which allows for a narrowly-tailored circumvention of the three-tier system.[87] Under the law, a small producer that qualifies as a "brewpub" may sell its beer directly to

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83. *See generally* W. John Jordan & Bruce L. Jaffee, *Use of Exclusive Territories in the Distribution of Beer: Theoretical and Empirical Observations*, 32 ANTITRUST BULL. 137 (1987).

84. *See generally* Tim R. Sass & David S. Saurman, *Mandated Exclusive Territories: Efficiency, Effects and Regulatory Selection Bias*, *in* 10 ADVANCES IN APPLIED MICROECONOMICS 55, 55–72 (2001).

85. *See* Burgdorf, *supra* note 72, at 7.

86. *BA Position Statements: Three-Tier Beer Distribution*, BREWERS ASS'N, https://www.brewersassociation.org/government-affairs/ba-position-statements/ (last visited Feb. 6, 2018).

87. *See* S.C. CODE ANN. §§ 61-4-1700 to -70 (2009 & Supp. 2017).

consumers on-site, thereby bypassing the distribution tier.[88] The law applies to very small producers: a "'[b]rewpub' means a tavern, public house, restaurant, or hotel which produces on the permitted premises a maximum of two thousand barrels a year of beer for sale on the premises."[89] A qualified brewpub may (1) produce up to two thousand barrels of beer a year for on-site consumption and to-go sale; (2) sell beer from other producers, which has gone through a distributor in compliance with the three-tier system; and (3) serve food and (if food is served) liquor.[90] Importantly, this law allows for a brewpub producer to act as a quasi-retailer and sell beer from other producers.[91]

Unfortunately, the brewpub designation remained all-or-nothing: a small-scale producer could sell its own beer to customers directly on-site as a brewpub or to distributors for off-premises retail as a producer within the three-tier framework, but not both.[92] A brewpub in South Carolina also cannot attend special events, like beer festivals or charity events.[93] Currently, twenty producers of beer in South Carolina legally operate under the brewpub designation, all of which legally operate as fully functioning restaurants while producing beer and possessing the option to offer beer for retail.[94] While a narrow exception to the traditional framework of state alcohol regulation, the brewpub law continues to have significant effects and marked a watershed moment in the history of progressive alcohol legislation for the state.

Since the brewpub law, South Carolina has passed several other notable pieces of legislation which have helped to spur growth in the craft beer industry. In 2010, South Carolina enacted two laws that permitted breweries to offer on-site beer tastings[95] and allowed licensed retailers to offer the same.[96] After these laws passed, a producer could offer two- to four-ounce tastings of its beer as a compliment to a brewery tour, at a cap of sixteen

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88. S.C. CODE ANN. § 61-4-1720 (2017).

89. S.C. CODE ANN. § 61-4-1700(1) (2009).

90. *Id.* § 61-4-1740.

91. *See id.* § 61-4-1740(2).

92. Because a producer must obtain a license to operate as a brewpub, he is confined to the activities permitted by the brewpub law; he may not obtain a brewpub license and a brewery license simultaneously. *See id.* § 61-4-1720.

93. *See* Brook Bristow, *Your Special Event Is Probably Illegal Now*, BEER OF SC (June 28, 2016), https://beerofsc.com/2016/06/28/your-special-event-is-probably-illegal-now/.

94. *See* Brook Bristow, *Breweries, Brewpubs, Contract, & Alt Props*, BEER OF SC, https://beerofsc.com/breweries/ (last visited Feb. 25, 2018).

95. *See* H.R. 4572, 2009–2010 Gen. Assemb., 118th Sess. (S.C. 2010) (previously codified as S.C. CODE ANN. § 61-4-1515(A) (2012)).

96. *See* S.C. CODE ANN. § 61-4-960(A) (Supp. 2017).

ounces a consumer.[97] Additionally, the law allowed a producer to sell up to 288 ounces of canned or bottled beer (the equivalent of twenty-four twelve-ounce cans) on-site for off-site consumption.[98]

This small but progressive step in the right direction was followed by a giant leap for the South Carolina craft brewing industry: the "Pint Law" of 2013.[99] The Pint Law, for the first time, allowed producers to sell up to four pints, or forty-eight ounces, of on-premises beer per customer per day, again in conjunction with a tour.[100] The law had no effect on the sale of to-go beer, which remained capped at 288 ounces.[101] While seemingly narrow in scope, effectively replacing the two- and four-ounce permitted samples with twelve-ounce drinks, the Pint Law had the effect of shifting the business of a South Carolina brewery from strictly production-focused to hospitality-focused as well, allowing breweries to realize direct economic success from consumers.[102] The Pint Law's effects were felt immediately and met with enthusiasm by brewers and patrons alike.[103] Importantly, the Pint Law does not apply to retailers, whose tastings must still comply with South Carolina Code section 61-4-960, which contains rigorous limitations, including that ten days prior to a tasting a retailer must give notice to the State Law Enforcement Division[104] and that no one retailer location may offer more than twenty-four beer tastings in a given year, for example.[105]

Just over a year later, South Carolina brewery owners toasted another victory as then-Governor Haley signed the "Stone Bill"[106] into law on June

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97. *Id.*

98. *See* S.C. CODE ANN. § 61-4-1515(E) (Supp. 2017).

99. *See* S.C. CODE ANN. § 61-4-1515(A) (2017).

100. *See id.*

101. *Id.* § 61-4-1515(E).

102. For insight into the economic effects of the Pint Law for the craft beer industry in South Carolina, see Brook Bristow, *New Economic Impact Data from the South Carolina Brewers Guild Shows More Growth*, BEER OF SC (Dec. 10, 2014), https://beerofsc.com/2014/12/10/new-economic-impact-data-from-the-south-carolina-brewers-guild-shows-more-growth/ (concluding that the Pint Law not only brought about economic success for existing breweries, but also helped to fuel an influx of new brewery openings throughout the state to the benefit of the overall state economy).

103. Westbrook Interview, *supra* note 37 ("The Pint Law made tap rooms [located on breweries premises] successful in a way that they could never have been previously."); *see also* Tug Baker, *Changes in State Law Fueled S.C.'s Brewery Boom*, FREE TIMES (Jan. 15, 2014), https://www.free-times.com/cover_story/changes-in-state-law-fueled-s-c-s-brewery-boom/article_6c9e38a2-8b45-5662-be10-a633b2ed2f15.html (gathering opinions from local brewers, patrons, and those in the legal field on the impact of the Pint Law).

104. *See* S.C. CODE ANN. § 61-4-960(A)(1) (Supp. 2017).

105. *See id.* § 61-4-960(A).

106. The bill was called the "Stone Bill" because it was motivated by a desire to entice Stone Brewing Company of San Diego to open a South Carolina location, an option the

2, 2014. The Stone Bill, now codified as section 61-4-1515(B) of the South Carolina Code, permits a brewery to sell food on-premises, provided that it obtains a permit from the Department of Health and Environmental Control (DHEC).[107] Although a seemingly minor change, the law had major implications. For one, a brewery that sold food under the necessary license was no longer regulated by the Pint Law as to how much beer it could sell on-site.[108] Instead, under the Stone Law, breweries were to be indirectly regulated by typical dram shop liability considerations.[109] Additionally, a brewery that qualified could apply for a permit that allowed it to sell beer and wine not produced on-site, given that it was obtained through the three-tier system.[110] Thus, breweries can now sell food on-site, offer beer to customers with no governmental regulations on the amount per customer, and continue to get their beer to retail markets through the traditional three-tier system. However, under the Stone Law, a brewery still could not serve liquor.[111] Brewers have met the law and its effects with enthusiasm.[112]

Even after the Stone Law, some difficulty for South Carolina brewers remained. Despite the net positive effect of the three-tier system, as well as its successful exceptions discussed previously, the system's rigidity combined with its numerous, highly specific exceptions constructed a confusing legal regime that proved, in some instances, difficult to navigate. The imperfections of the regime are exemplified by a case recently in front of the South Carolina Administrative Law Court.[113] There, Hunter-Gatherer,

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California brewer seriously considered. Although Stone settled elsewhere, the resulting law had a monumental effect on the craft beer industry in South Carolina. For a full discussion of the Stone Bill and its subsequent effect on South Carolina's craft brewing industry, see T.A.C. Hargrove II, *Stone Didn't Come, but We Got the Bill: An Analysis of South Carolina Laws Affecting Craft Brewers*, 9 CHARLESTON L. REV. 335 (2015) (discussing the Stone Law's arrival in South Carolina, as well as providing a legal analysis of the then-current legal regulation of beer in South Carolina within the three-tiered framework).

107. *See* S.C. CODE ANN. § 61-4-1515(B)(1) (Supp. 2014).

108. *See id.* ("In addition to the sales provisions set forth in [The Pint Law], a brewery [is] permitted in this State . . . .").

109. For South Carolina's version of dram shop liability laws, see S.C. CODE ANN. § 61-6-2220 (2009).

110. *Id.* § 61-4-1515(B)(1).

111. *See id.* § 61-4-1515(B); *see also* Brook Bristow, *The Brewpub Bill—What It Does and Why Your Favorite Pub Might Be Changing*, BEER OF SC (Mar. 27, 2017), https://beerofsc.com/2017/03/27/the-brewpub-bill-why-your-favorite-watering-hole-might-be-changing/ ("Breweries can't sell liquor, even with the new allowance for food sales under the Stone Law like a restaurant would be able to do.").

112. Westbrook Interview, *supra* note 37 (commenting that the law has helped to generate business and noting that compliance with the law's requirements is relatively easy).

113. *See* Hunter-Gatherer, LLC v. S.C. Dep't of Revenue, 16-ALJ-17-0031-CC, 2016 WL 2619600, at *1 (S.C. Admin. Ct. May 2, 2016).

a popular brewpub in Columbia, South Carolina, that emerged as a result of the original brewpub exception,[114] applied to DOR for permits to open a new brewery.[115] Hunter-Gatherer looked to take advantage of the new Stone Law by expanding and opening a second location, this time as a brewery, which would allow the producer access to widespread distribution of its beer.[116] DOR denied Hunter-Gatherer the requested permits, concluding that as a brewpub, Hunter-Gatherer was a retailer in the eyes of the law and therefore could not operate on the production tier as a brewery.[117] A creature of legal fiction, the brewpub had not previously been defined as belonging to any one tier. In the DOR's denial of Hunter-Gatherer's permit requests, it asserted that brewpubs operated on the retail tier.[118] Hunter-Gatherer argued instead that brewpubs are hybrid operations that straddled the line between producer and retailer.[119]

The administrative law court agreed with Hunter-Gatherer, finding that a brewpub license was a hybrid license that existed outside of the three-tier system.[120] Relying on the Geathers' treatise,[121] the administrative law court concluded that "the clear purpose [of the brewpub legislation] is to foster the growth of brewpubs by allowing them to lawfully engage in both manufacturing and retail activity which might otherwise run afoul of the state's three-tier statute."[122] The court was explicit in its holding that a brewpub does not belong to, and therefore is not confined by, the constraints of any one tier: "Brewpubs constitute an exception allowing one to essentially straddle two tiers, rather than identifying themselves with any one tier."[123] While DOR contended that exceptions to the three-tier system still exist within its framework, the court opined that the brewpub exception exists entirely outside the three-tier system relying on the language of section 61-4-1515(D)(5), which states: "Changes to the brewery laws pursuant to subsection (B) and [the brewpub exception] do not alter or amend the structure of the three-tier laws of this State, and the wholesalers and the breweries must not discriminate in pricing at the producer or wholesaler levels."[124] Thus, the court reversed DOR's denial of Hunter-

114. *Id.* at *1.
115. *Id.* at *2.
116. *See id.*
117. *See id.*
118. *Id.* at *3.
119. *Id.* at *1.
120. *Id.* at *7.
121. *Id.* at *6; THE GEATHERS' TREATISE, *supra* note 8, is also relied upon by this Note.
122. *Hunter-Gatherer*, 2016 WL 2619600, at *6.
123. *Id.* at *7.
124. S.C. CODE ANN. § 61-4-1515(D)(5) (Supp. 2014).

Gatherer's permit requests, thereby allowing it to operate a brewpub and brewery simultaneously.[125] Under the court's holding, the owner of a brewpub could also likely hold ownership in a retail establishment.[126] DOR appealed the decision to the South Carolina Court of Appeals, but both parties agreed to voluntarily dismiss the case after a new law made the outcome moot.[127]

Two new laws have made a potential court of appeals review largely moot. Even in the face of Hunter-Gatherer's victory in the administrative law court, owners of brewpubs faced two significant legal frustrations: first, beer produced by brewpubs could not be sold (or given away) at special events, and second, beer produced by brewpubs could not reach retailers through the three-tier system.[128] Recently, the South Carolina legislature passed a pair of laws that afford brewpubs more options. Senate Bill 114, signed into law May 19, 2017, allows producers, distributors, as well as brewpubs to donate their products for sale and on-premises consumption to licensed special events hosted by nonprofit organizations.[129] Signed into law the same day, Senate Bill 275, codified at section 61-4-1515(F) of the South Carolina Code, allows the owner of a brewpub to relinquish his or her license as such and obtain a brewery license.[130] Importantly, the bill also amended the regulations that pertain to licensed breweries, so that brewery owners may now apply for a license to sell liquor "for on-premises consumption within a specified area of its licensed or permitted premises physically partitioned from the brewing operation and designated for the purpose of engaging substantially and primarily in the preparation and serving of meals."[131] Under the legal designation of brewery, a former brewpub would have all the legal benefits of a brewery, including the right to attend festivals and, more importantly, to distribute its product through the three-tier system.[132] Because the law allows for a brewery to obtain a liquor

125. *Hunter-Gatherer*, 2016 WL 2619600, at *8.

126. Given that the administrative law court considers a brewpub to be an exception to the three-tier framework and exempt from a tier designation, and given that the court allowed Hunter-Gatherer to simultaneously act as a brewpub and producer, it follows that the court would likely allow a brewpub owner to also operate as a retailer.

127. *Hunter-Gatherer*, 2016 WL 2619600, at *8.

128. *See* Bristow, *supra* note 102 ("Time and time again, the biggest complaint I hear from brewpub clients is the inability to sell their beer beyond their four walls—mainly to a wholesaler to distribute for you to buy from retailers or to serve beer at a festival to promote themselves.").

129. S.C. CODE ANN. § 61-2-185(D) (Supp. 2017).

130. *See* S.C. CODE ANN. § 61-4-1515(F) (Supp. 2017).

131. *Id.* § 61-4-1515(B)(2).

132. *See id.* § 61-4-1515.

license, a converted brewpub could maintain its ability to sell liquor after converting to a brewery. Therefore, the new law resolves the brewpub law's all-or-nothing difficulty. A brewpub that converts to a brewery could continue to function as a brewpub while being legally designated as a brewery, thus not being relegated to the 2,000-barrel-a-year production ceiling while being able to distribute its beer through the three-tier system.

However, the brewpub conversion law did not resolve all the issues plaguing brewpub owners. Even given the significant benefits of converting from a brewpub to a brewery, producers are left with an interesting choice of whether to hold a permit as a brewery or as a brewpub. After the Stone Law, discussed *supra*, operating as a brewery would allow a producer to sell food, produce beer with no production cap, get beer to retailers through the three-tier system, offer to-go beer with a 288-ounce cap, and sell outside beer and wine.[133] And, with the recent addition of section 61-4-1515(B)(2), operating an establishment under the brewery designation would allow for the sale of liquor as well.[134] On the other hand, a brewpub is not subject to any limit on to-go beer, unlike a brewery.[135] Additionally, since brewpubs are considered hybrids that exist outside of the three-tier system, owners of a brewpub may own a retail space, such as a bottle shop or restaurant without violating South Carolina's tied-house law. A brewery, however, fits squarely in the production tier and is therefore subject to South Carolina's tied-house statute, which prohibits ownership across tiers.[136]

These are significant factors that must be considered for brewpub owners. For example, a restaurant that operates as a brewpub might remain under the legal designation of brewpub, rather than converting to a brewery, so that it could continue to own and operate a bottle shop it also owns, without violating the tied-house statute. Such a decision would come at the price of remaining subject to the law's prohibition on brewpubs getting their beer to retailers through the three-tier system. It seems likely that if such a restaurant were to utilize the brewpub conversion law and convert to a brewery, becoming legally a member of the production tier, its ownership interest in any retail location would violate South Carolina's tied-house statute.

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133. *See supra* notes 106–112 and accompanying text (discussing the Stone Law and its effects).

134. S.C. CODE ANN. § 61-4-1515(B)(2) (Supp. 2017).

135. *See* Bristow, *supra* note 102 ("[Under the Stone Law] breweries still have a cap of 288 ounces per day of beer to go.").

136. *See* discussion *supra* p. 11 (regarding South Carolina's tied-house statute); *see also* S.C. CODE ANN. § 61-4-940(D) (Supp. 2014).

Despite these recent steps forward, the legal system that governs the craft beer industry still includes a number of antiquated laws, the defining purposes of which have long left the public consciousness. While laws like South Carolina's tied-house statute provide a necessary barrier that prevents large-scale producers from vertically integrating and thus inhibiting market competition, the law serves no purpose when it is applied to small-scale producers, who make up the vast majority of brewers. Therefore, South Carolina should carve out exceptions to laws like the tied-house statute whose purpose only applies effectively to large-scale producers. An exception to the tied-house statute based on yearly production, for example, would allow a small brewery to own a small bottle shop. Such an exception would allow small producers greater access to market, by allowing self-retail. At the time these laws were passed, they applied to all producers, reflecting the anti-alcohol sentiments of the era in which they were developed. Today, the craft beer industry is defined by passionate artisan producers and a mainstream, productive customer base that favors quality over quantity.

D. State Taxation of Beer

Tax is the most expensive ingredient in your beer.[137] Beer, because of its previously discussed unpopular past, is taxed seventy percent higher than the average product on the market.[138] A recent economic study found that taxes, levied on all three tiers of the industry, amount to over forty percent of the retail price consumers pay for beer.[139] Additionally, taxes on the production and distribution of beer are included in the price used to compute sales taxes, forcing the consumer to, in essence, pay a tax on a tax.[140] All fifty states and the District of Columbia impose some tax on beer above and

137. BEER INST., BEER TAX FACTS: THE ECONOMIC AND SOCIETAL IMPACTS OF STATE AND FEDERAL TAXES ON BEER 2 (2014), https://www.finance.senate.gov/imo/medme/doc/Beer%20Institue%204.pdf [hereinafter BEER INSTITUTE TAX REPORT]; *see also* BEER INST., BEER SERVES AMERICA: ECONOMIC IMPACT OF THE BEER INDUSTRY (2014), http://mnbwa.com/wp-content/uploads/2015/08/Output-Tax-State.pdf.

138. BEER INSTITUTE TAX REPORT, *supra* note 137, at 2.

139. *Id.*

140. *Id.* at 5 ("First, the excise tax on beer is levied, by law, at the brewery and becomes an indistinguishable part of the product cost as it moves through the distribution system. Like other costs, it is marked up by wholesalers and again by retailers. It is also included in the price used to compute state and local sales taxes, thus causing consumers to pay a tax on a tax. As a result, beer drinkers actually end up paying about $2.00 out-of-pocket for each $1.00 of tax levied by government.").

beyond the general sales tax, called an excise tax.[141] South Carolina claims the nation's seventh highest excise tax on beer, at $0.77 taxed on every gallon of beer.[142] South Carolina's excise tax applies to each sale of beer, regardless of tier: for example, a brewpub must pay the excise tax when its beer is sold directly to consumers.[143] Even though the Pint and Stone Laws currently allow South Carolina brewers to sell beer directly to consumers, breweries must still pay excise taxes on that beer which bypasses the three-tier system.[144] While the state and federal government both impose taxes, this Note will focus on the efforts South Carolina could make in scaling back state taxes.

Not unlike other areas of alcohol regulation, government agencies cite the negative influence of alcohol on the community as justification for such weighty taxation.[145] One such justification is the "social cost" that problem drinkers impose on society; the Center for Disease Control (CDC) released a government-sponsored study which claimed that problem drinkers cost the United States $223.5 billion a year.[146] Reviewers have found this study problematic.[147] Lawmakers also justify the high rate of taxation as an effort to curb alcohol abuse, although some doubt the causation of such logic.[148] In fact, the Supreme Court has noted that "the evidence suggests that the abusive drinker will probably not be deterred by a marginal price increase, and that the true alcoholic may simply reduce his purchases of other necessities."[149]

High taxation rates on beer have serious consequences for the industry. State tax increases have a direct correlation on job loss in the beer industry, and consumers buying across state lines for cheaper, less tax-burdened beer can exacerbate that issue.[150] Since most of the taxes on beer are "hidden taxes" (i.e., those that are incorporated into the price the consumer sees on the shelf rather than the one they see tacked onto their total on the receipt),

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141. *See* Scott Drenkard, *How High Are Beer Taxes in Your State?*, TAX FOUND. (Mar. 17, 2016), https://taxfoundation.org/how-high-are-beer-taxes-your-state-0/.

142. *See* S.C. CODE ANN. § 12-21-1020 (2012).

143. S.C. CODE ANN. § 12-21-1035(A) (2014).

144. S.C. CODE ANN. § 61-4-1515(A)(6) (2017).

145. BEER INSTITUTE TAX REPORT, *supra* note 137, at 6.

146. *Id.*

147. *See id.* ("[The results of the CDC's study are] a far cry from the $12 billion estimated by independent economists . . . and is simply the latest in a long series of such government-funded studies reporting higher and higher estimates over the last two decades—despite the fact that the major empirical indicators of alcohol abuse, drunk driving, and underage drinking have all greatly declined over this time period.").

148. *See id.* at 8.

149. 44 Liquormart, Inc. v. Rhode Island, 517 U.S. 484, 506 (1996).

150. BEER INSTITUTE TAX REPORT, *supra* note 137, at 4.

consumers are likely to believe craft beer is a more expensive product than it would otherwise be.[151] But high beer taxes affect more than just those in the industry. These taxes disparately affect the middle and lower classes over the rich.[152] In fact, studies have found that the beer tax is one of the most discriminatory in the nation, as households with yearly incomes of $50,000 or less pay nearly half of all beer tax funds.[153] Finally, studies have found the excise tax on beer to be an inefficient means of raising revenue.[154] Thus, South Carolina's tax policy should more accurately reflect societal attitudes regarding beer, and the excise tax on beer should be eliminated or vastly reduced.

III. REGULATION OF THE CRAFT BEER INDUSTRY IN NORTH CAROLINA AND GEORGIA

Likely due to the big-city markets of Charlotte and Atlanta, North Carolina and Georgia both have considerably larger craft beer industries than that of South Carolina; the industry in each state had well over a billion dollar state economic impact in 2016.[155] Despite the disparity in market size, comparisons between South Carolina and its neighbor states are helpful in uncovering which recent changes have produced immediate effects for the craft beer industry and which laws have been met with enthusiasm by industry members. Given the surge of new breweries opening across the nation,[156] the industry is very active in effecting, calling for, and reacting to legal change. In North Carolina, Georgia, and South Carolina, brewers, wholesalers, and retailers have vocally advocated for, and responded to, changes in each state's respective regulation scheme. Comparing these

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151. *See* John Dunham & Assoc., *Beer Serves America: Economic Impact of the Malt Brewing Industry in 2014*, http://mnbwa.com/wp-content/uploads/2015/08/Output-Tax-State.pdf (last visited Mar. 15, 2018).

152. BEER INSTITUTE TAX REPORT, *supra* note 137, at 3.

153. *Id.* (citing Andrew Chamberlain & Gerald Prante, *Who Pays Taxes and Who Receives Government Spending? An Analysis of Federal, State and Local Tax and Spending Distributions, 1991–2004*, at 45 (Tax Found., Working Paper No. 1, 2007)).

154. *Id.* at 5.

155. *Georgia Craft Beer Sales Statistics, 2016*, BREWERS ASS'N, https://www.brewersassociation.org/statistics/by-state/?state=GA (last visited Oct. 15, 2017) (noting that the craft beer industry had a $1.596 billion state impact in 2016); *North Carolina Craft Beer Sales Statistics, 2016*, BREWERS ASS'N, https://www.brewersassociation.org/statistics/by-state/?state=NC (last visited Oct. 15, 2017) (noting that the craft beer industry had a $2 billion state impact in 2016).

156. *Historical U.S. Brewery Count*, BREWERS ASS'N, https://www.brewersassociation.org/statistics/number-of-breweries/ (last visited Nov. 7, 2017) (reporting the recent increase in breweries and brewpubs around the country).

reactions, as well as supporting data, helps illuminate which changes have promoted growth within the craft beer industry.

A. Beer Laws in North Carolina and Georgia

Both North Carolina and Georgia operate under the three-tier framework, in which a brewer must sell to a distributor, who can then sell to a retailer, who can finally sell to the public.[157] North Carolina has carved out a few significant exceptions to the divorcement of producer, distributor, and retailer. A brewer, holding a license as a producer, who produces less than 25,000 barrels a year may obtain a distributor license for the purpose of self-distribution in North Carolina.[158] Recently, House Bill 500 included a provision that would remove that production cap, allowing any producer to self-distribute. That provision was subsequently removed from the bill.[159] As another exception to the three-tier system, North Carolina allows any brewery to obtain a retailer license for the purpose of on-site sale of to-go beer.[160] But North Carolina still has some restrictive adherence to the three-tier system; like South Carolina,[161] the state has its own version of a tied-house statute, with no exception that applies to small-scale brewers.[162] Similar to section 61-4-940 of the South Carolina Code, North Carolina law goes as far as prohibiting a producer or distributor from lending or giving any "money, service, equipment, furniture, fixtures or any other thing of value" to the other.[163]

Until recently, the Georgia beer industry operated under one of the strictest three-tier systems in the country.[164] Before September 1, 2017, Georgia's three-tier system remained almost wholly intact,[165] subject to only two limited exceptions: a brewpub exception in which a producer of beer that also acts as a restaurant could sell its beer directly to consumers,[166] and

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157. *See* N.C. GEN. STAT. §§ 18B-1100 to -19 (2011) (North Carolina three-tier laws); *see also* GA. CODE ANN. §§ 3-5-20 to -38 (2015) (Georgia three-tier laws).

158. N.C. GEN. STAT. § 18B-1104(a)(8) (2011).

159. *Self-Distribution and Franchise Provisions Stripped from NC Bill*, BREWERS ASS'N, https://www.brewersassociation.org/current-issues/self-distribution-and-franchise-provisions-stripped-from-nc-bill/ (last visited Oct. 19, 2017).

160. N.C. GEN. STAT. § 18B-1104(7) (2011).

161. S.C. CODE ANN. § 61-4-940(D) (2012).

162. *See* N.C. GEN. STAT. § 18B-1116(a) (2011).

163. *Id.* § 18B-1116(a)(3).

164. Before the recent passage of section 3-5-24.1, Georgia was one of two states left in the nation that did not allow producers to sell beer directly to consumers (other than limited tour-tasting exceptions). *See* GA. CODE ANN. § 3-5-24.1 (2017).

165. *See* GA. CODE ANN. §§ 3-5-30 to -33 (2015).

166. *See id.* § 3-5-38.

a disingenuous "brewery tour" exception in which a brewery could offer a very limited amount of beer directly to a tour-goer for free, as an educational aide to the tour on-site[167] or as a to-go souvenir of the same.[168] In September of 2017, however, Georgia General Statute section 3-5-24.1 went into effect, allowing a producer of beer to sell directly to consumers for on-site and to-go consumption.[169] While the statute labels itself as a "limited exception" to Georgia's three-tier system, the law has brought about the most affecting and producer-friendly change to the craft beer industry in the state since the years following prohibition.[170] The law sparked immediate changes in Georgia breweries, who embraced the new policy by transforming breweries into more consumer-friendly "hangouts."[171] Georgia also has its own tied-house statute, which, with similar language to those of its neighbors, prohibits a producer from "enjoying ownership interest" in any business of a distributor or retailer.[172]

Like South Carolina, North Carolina and Georgia each have their own version of franchise laws. In North Carolina, franchise laws generally favor the distributor over the producer, as is commonplace given the laws' origins; however, North Carolina has carved out exceptions that favor small-scale producers, restoring some ground in the balance of power for small brewers. Generally, a producer's ability to terminate or fail to renew a contract with a distributor requires ninety days' notice, a period of forty-five days in which a distributor can cure, and "good cause" on the part of the producer.[173] Immediate termination is only permitted upon the distributor's insolvency, loss of license, conviction of a felony, fraudulent conduct in dealing with the

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167. *See id.*

168. *See id.*

169. *See* GA. CODE ANN. § 3-5-24.1 (2017) ("A limited exception to the provisions of this title providing a three-tier system for the distribution and sale of malt beverages shall exist to the extent that the license to manufacture malt beverages in this state shall include the right to sell up to 3,000 barrels of malt beverages per year produced at the brewer's licensed premises to individuals . . . .").

170. *See* Reid Ramsay, *Georgia's Beer Bill Now Law*, BEER STREET J. (May 8, 2017), http://beerstreetjournal.com/georgia-beer-bill-now-law/ (noting that several Georgia breweries expanded tap lists, renovated facilities to better support "hangout" crowds, hired more employees, expanded hours of operation, and even planned additional locations in response to the new law).

171. *See id.*; *see also* Dave Eisenberg, *Following Direct Sales Bill Georgia's Wild Heaven Beer to Open Second Location*, GOOD BEER HUNTING (Mar. 23, 2017), http://goodbeerhunting.com/sightlines/2017/3/23/following-direct-sales-bill-georgias-wild-heaven-beer-to-open-second-location.

172. GA. CODE ANN. § 3-5-32 (2015).

173. N.C. GEN. STAT. § 18B-1304 (2009) ("[A producer may not] alter in a material way, terminate, fail to renew, or cause a wholesaler to resign from, a franchise agreement with a wholesaler except for good cause and with the notice required by G.S. 18B-1305.").

brewer, failure to pay for delivered beer, or transfer of the business without notice to the brewer.[174] Absent one of these conditions precedent, a producer must show "good cause" in order to terminate a contract, which the statute explicitly notes does not include "[f]ailure of the [distributor] to meet standards of operation or performance that have been imposed or revised unilaterally by the [producer] . . . ."[175] Like in South Carolina, then, North Carolina producers are susceptible to poor performance of the contract by distributors with costly legal recourse being the only available remedy.

Unlike South Carolina, North Carolina has carved out an exception that alleviates this concern for very small brewers: a brewery that produces fewer than 25,000 barrels may terminate or fail to renew a franchise contract, absent good cause, following the fifth business day after confirmed receipt of written notice and payment of fair market value of the distribution rights.[176] This exception effectively eliminates the problem that franchise laws create for small brewers: the risk of becoming trapped in an ineffective relationship with a distributor with no economically feasible way to cancel the contract. The exception not only provides small brewers in North Carolina with a fair and cost-efficient means of getting out of a bad contract, but it also eliminates the negative race-to-the-bottom incentive structure found in traditional beer franchise laws. In addition, the exception remains narrow enough that the laws continue to serve their primary purpose of protecting independent distributors from abuse by large-scale producers that have considerable bargaining power advantage. The North Carolina small-brewer exception to its franchise laws reflects the needs of the industry by protecting against market abuses by large-scale producers while not restraining the ability of small-scale producers to operate within the free market. However, the exception is very narrow, and only the smallest breweries satisfy the requirements of the exception.[177]

Georgia's franchise laws are even more rigorous than those of South Carolina[178] and include no small-producer exception akin to the one found in North Carolina's franchise laws.[179] Under Georgia law, producers may terminate a contract with a distributor only after filing a termination notice with the state, which must set forth specific reasons for the request.[180] After

174. *See* N.C. GEN. STAT. § 18B-1305(c) (2009).

175. *Id.* § 18B-1305(d).

176. *Id.* § 18B-1305(a)(1).

177. *See id.*

178. *Compare* S.C. CODE ANN. § 61-4-1100 (2009), *with* GA. CODE ANN. §§ 3-5-29 to -34 (2015).

179. *See* N.C. GEN. STAT. § 18B-1305(a)(1) (2009).

180. *See* GA. COMP. R. & REGS. 560-2-5.10 (2017).

the request is filed, the law gives both the distributor and the state thirty days to object and request a hearing.[181] If no objection is filed, the termination request becomes effective; if an objection is filed and a hearing is held, the Georgia Department of Revenue has the ultimate authority to grant or deny the termination request.[182] The law sets a high bar for contract termination, listing acceptable reasons for a producer to terminate: "A [distributor's] bankruptcy or serious financial instability"; "[a distributor's] repeated violation of any provision of federal or state law or regulation"; and "[a distributor's] failure to maintain sales volume of the Brand reasonably consistent with sales volumes of other [distributors] of that Brand."[183] Like the law in South Carolina, franchise laws in Georgia place heavy limitations on a brewer's freedom of contract by requiring significant malfeasance on the part of a distributor and by forcing a producer to endure a costly and inefficient process before allowing that producer to terminate a contract with its distributor.

B. Taxation of Beer in North Carolina and Georgia

Georgia boasts the nation's fourth highest state excise tax on beer.[184] For draft beer—beer sold directly from a keg—state and local excise taxes amount to over seventy cents per gallon sold.[185] For packaged beer, sold in bottles or cans, excise taxes in Georgia amount to one dollar and one cent per gallon.[186] Unlike in South Carolina, excise taxes in Georgia are broken up into two categories—state excise taxes and local gallonage taxes.[187] Like in South Carolina, these taxes are "hidden taxes,"[188] the result of which, as discussed *supra*, is that customers are unlikely to realize that the cost is the result of tax. After the hidden taxes are applied, general sales taxes are calculated and added to the final price at the same rate as the general retail sales tax for other sales made in the state.[189]

North Carolina's excise tax on beer is only a few cents short of South Carolina's rate, at just over sixty-one cents.[190] Beer in North Carolina is not taxed beyond that by local or special taxes, aside from the general sales tax

181. *See id.*
182. *See id.*
183. *Id.*
184. *See* Drenkard, *supra* note 141.
185. *See* GA. CODE ANN. § 3-5-60 (2015).
186. *See id.*
187. *See id.*
188. *See* Dunham & Assoc., *supra* note 151.
189. *See id.*
190. *See* N.C. GEN. STAT. § 105-113.80 (2009); *see also* Drenkard, *supra* note 141.

on the retail level applicable to any other product sold in the state. Georgia, North Carolina, and South Carolina each boast some of the highest beer excise tax rates in the country.

IV. PROGRESSIVE POLICIES IN OTHER STATES

Around the country, lawmakers have taken note of the positive economic impact of the craft beer industry and responded in the form of legislation that has eased tax burdens, encouraged the industry's potential for tourism, and eased the regulatory burdens on small-scale production.

In addition to North Carolina, several states have passed small-brewery exceptions to traditional franchise laws, most of which have a higher limit than North Carolina's 25,000-barrel-a-year limit. Arkansas, Colorado, Illinois, Indiana, Nebraska, New York, Oklahoma, Utah, and Washington all provide small-brewer exceptions that exempt brewers producing less than a certain barrelage per year from the state's franchise laws.[191] Some states, like Washington,[192] apply their exception to brewers producing as many as 200,000 barrels a year, while other states, like Utah,[193] keep the exception extremely narrow, applying to brewers who produce less than 6,000 barrels a year. Other exceptions are more creative and more accurately adhere to the purpose of franchise laws: in New York, for example, any brewery that produces less than 300,000 barrels can terminate a franchise agreement with a distributor without good cause and upon payment of fair compensation, given that the brewer makes up less than three percent of the distributor's annual business.[194] Because this law only applies to a producer that has no unfair bargaining advantage over its distributor, it best reflects the purpose for which franchise laws were enacted.

While a number of states provide tax incentives specifically for craft breweries, New York has passed legislation that provides incentives to craft brewers through financial grant support and tax breaks. Noting the positive economic impact of the craft beer industry on the state,[195] New York legislators passed laws in 2012 that provide refundable corporate franchise

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191. *See* Sorini, *supra* note 52.

192. *See* WASH. REV. CODE § 19.126.020 (2014).

193. *See* UTAH CODE ANN. § 32B-1-102(105) (West 2012).

194. *See* N.Y. ALCO. BEV. CONT. LAW § 55-c (LexisNexis 2016).

195. *See* New York State Senate, *Press Release: Senate Passes Bills to Grow Craft Brewing Industry in New York* (June 18, 2012), https://www.nysenate.gov/newsroom/press-releases/senate-passes-bills-grow-craft-brewing-industry-new-york ("New York's craft breweries create fantastic beer, but just as important, they have a strong and growing impact on our economy because they create jobs, support agriculture and promote tourism.").

and personal income tax credits for beer produced in New York[196] and exempt "farm breweries"[197] from burdensome tax filing requirements.[198] In 2016, the state passed an additional credit for the craft beer industry, the New York Alcoholic Production Credit, which effectively offsets the state excise tax by offering up to $745,000 in tax credits at a certain rate per gallon produced.[199] Additionally, New York offers up to three million dollars a year in grants to craft breweries in an effort to promote locally made beer and cider.[200] In 2016, the New York craft beer industry ranked ninth among states in amount of craft beer produced, while having the fourth largest economic impact on its state at $3.439 billion.[201] South Carolina should emulate the progressive tax policy in New York with regard to small-scale producers of beer in recognition of the positive economic impact the industry has on the state.

V. RECOMMENDATIONS

While largely rooted in antiquated sentiments, the three-tier system in South Carolina remains the craft industry's greatest defense against the potential market dominance that vertical integration would offer for large-scale producers. Given its modern purpose, South Carolina should provide exceptions to the three-tier system's general framework for small-scale producers. Passing an exception to the tied-house statute, for example, would provide craft producers flexibility in getting their product to market, while preserving the law's central purpose as a defense against the undue influence and power concentration of large-scale producers.

The largest hindrance to success in the South Carolina craft beer industry remains the franchise laws that regulate contracts between producers and distributors.[202] While some South Carolina producers have great relationships with their distributors, those producers consider themselves lucky. A producer that contracts with a distributor is bound to

196. *See* N.Y. TAX L. § 37 (LexisNexis 2014).

197. N.Y. ALCO. BEV. CONT. LAW § 51-a (LexisNexis 2016) (A "Farm Brewery" is a small producer that uses primarily local ingredients to brew between fifty (50) and seventy-five thousand (75,000) barrels a year.).

198. *See* N.Y. TAX L. § 1136 (LexisNexis 2014).

199. *See* N.Y. TAX L. §§ 1101(b)(19); 1105-B; 1115(a)(12), (19), and (33); 1118(13) (LexisNexis 2016).

200. *See Craft Beverage Grant Program*, N.Y. STATE BINDER (2016), https://esd.ny.gov/craft-beverage-grant-program.

201. *See New York Craft Beer Sales Statistics, 2016*, BREWERS ASS'N, https://www.brewersassociation.org/statistics/by-state/?state=NY (last visited Mar. 26, 2018).

202. *See* Westbrook Interview, *supra* note 37; *see also* Hindy, *supra* note 51.

that contract until the distributor misperforms the contract egregiously enough to warrant legal action. Working in tandem with franchise laws' unwaivable contract provisions, mandated exclusive territory laws ensure that distributors will not be motivated by competition within any given territory. To cancel or fail to renew a contract, South Carolina producers must still go through the expensive process of termination.[203]

Such restraint on the ability to contract goes against the fundamental freedom that provides the basis of contract law as well as the principles of free market capitalism. The climate that necessitated that laws apply to all producers has long since subsided. Therefore, South Carolina should adopt a franchise law exemption similar to those found in states like New York and Washington for brewers that produce less than a certain number of barrels per year. Importantly, the exemption would continue to protect independent distributors that possess significantly less bargaining power in contracts with large corporate suppliers. Thus, a small-producer franchise law exemption in South Carolina would allow small brewers to contract fairly and hold distributors accountable for proper execution of the contract without having to expend significant time and resources, while continuing to protect independent distributors from abuse in contractual relationships of unequal bargaining power.

Finally, South Carolina should adopt incentivizing policies for the craft beer industry akin to those of New York. The craft beer industry in South Carolina had a $650 million impact on the state in 2016,[204] and craft breweries have provided a new tourism draw throughout the state. Policies in New York have been met with enthusiasm by brewers throughout the state and have encouraged activity in the local economy by promoting locally-made and locally-sourced products. South Carolina should follow suit to promote the further growth of the craft beer industry in the state.

VI. CONCLUSION

The century-old motivations which prompted the enactment of the laws that today provide the foundation for craft beer regulation have all but left the public consciousness. Threats of the amoral nature of alcohol and the influence of organized crime networks, concerns that once defined alcohol regulation, no longer play a major role in the public discourse. However, while some purposes of these laws are undoubtedly obsolete, today, the laws provide a different but vital purpose for the craft beer industry. The

203. *See* S.C. CODE ANN. § 61-4-1100(1)(b) (Supp. 2014).
204. *S.C. 2016 Statistics*, *supra* note 3.

fundamental requirement of the three-tier system and central provisions of franchise laws serve to ensure fair market competition by protecting small brewers from the market domination of large-scale producers through influence over retailers and vertical integration over all three tiers. These prevailing purposes do not necessitate restraining free market principles for craft producers, and exceptions that benefit small-scale producers would not disturb those vital purposes. Therefore, South Carolina should continue to regulate the alcohol industry through the current frameworks already in place, while implementing exceptions for small-scale producers.

Wilson Daniel

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